

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Third Party Communication: None
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Person To Contact: _____, ID No. _____

Telephone Number: _____

Refer Reply To:
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PLR-131229-07
Date:
November 07, 2007

Legend

X =

Trust =

A =

B =

a =

Date1 =

Date2 =

Date3 =

Date4 =

Year1 =

Year2 =

Dear _____ :

This responds to a letter dated June 28, 2007, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under §1362(f) of the Internal Revenue Code.

The information submitted states that X elected to be an S corporation effective Date1. A and B, husband and wife, each owned a% of the stock of X. On Date2, B died. Trust was created under the Will of B, which named A the sole income and principal beneficiary of Trust during A's lifetime. On Date3, the stock of X owned by B was transferred to Trust from B's Estate, pursuant to the terms of B's Will. These shares of X are the only assets held by Trust. X represents that Trust is qualified to be treated as a qualified subchapter S trust (QSST) described in § 1361(d), except that A failed to make the election under § 1361(d)(2). Therefore, Trust ceased to be an eligible S corporation shareholder on Date4, pursuant to §1361(c)(2)(A)(iii), and X's S corporation election terminated on Date4.

X represents that for the tax years Year1 to Year2, X and X's shareholders have filed tax returns consistent with X being an S corporation. X further represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time since Date4 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust, all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(c)(2)(A)(iii) provides that for purposes of § 1361(b)(1)(B), a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it, may be an S corporation shareholder. Section 1361(c)(2)(B)(iii) provides that for purposes of

§ 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(iii), the estate of the testator shall be treated as the shareholder.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1362(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the QSST election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on or after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a

reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date4, resulting from the failure of A, as the beneficiary of Trust, to make the election under § 1361(d)(2).

We further conclude that the termination was inadvertent within the meaning of § 1362(f). In addition, we conclude that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date4 and thereafter, provided that Trust qualifies as a QSST and X's election to be an S corporation was otherwise valid and was not terminated under § 1362(d). Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. For this purpose, A, as the current income beneficiary of Trust, shall be treated as the shareholder of X with respect to the stock of X held by Trust, beginning Date4. If X or its shareholders fail to treat X as described above, this letter ruling shall be null and void.

This ruling is conditioned on A filing a QSST election under § 1361(d)(2) with respect to Trust, effective Date4, with the appropriate service center within 60 days from the date of this letter. A copy of this letter should be attached to the QSST election.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b), whether Trust is a QSST within the meaning of § 1361(d)(3), or whether X's S corporation election may have terminated under § 1362(d)(3) for having passive investment income exceeding 25 percent of gross receipts for 3 consecutive taxable years when X had accumulated earnings and profits.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes